MEMO# 30445

December 5, 2016

SEC Publishes Notice of Proposed Amendments to the Limit Up-Limit Down Plan

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TO: Equity Markets Advisory Committee
ETF (Exchange-Traded Funds) Committee
ETF Advisory Committee RE: SEC Publishes Notice of Proposed Amendments to the Limit Up-Limit Down Plan

The Securities and Exchange Commission ("SEC" or "Commission") recently published for comment a proposal to amend the National Market System Plan to Address Extraordinary Market Volatility ("Limit Up-Limit Down Plan")[1] The Proposed Amendments aim, in part, to address concerns with the operation of the plan in the wake of the market volatility that occurred on August 24, 2015. Specifically, the Proposed Amendments are designed to reduce the number of repeat limit up-limit down trading pauses in a particular security. These repeat trading pauses contributed to the confusion and uncertainty on August 24, 2015.[2] This memorandum provides an overview of the Limit Up-Limit Down Plan and summarizes the Proposed Amendments.

The comment period for the Proposed Amendments closes on December 23. **If you have views on the proposal, please contact George Gilbert at** george.gilbert@ici.org **by December 9.**

Overview of the Limit Up-Limit Down Plan

The Commission approved the Limit Up-Limit Down plan in 2012 to create a market-wide harmonized mechanism for addressing extraordinary market volatility in individual stocks. The plan aims to prevent trades from occurring outside of price bands above and below a security's reference price. The plan requires all trading centers (e.g., exchanges and alternative trading systems) for covered securities to enforce written policies and procedures that are reasonably designed to prevent trades that are below the lower price band or above the upper price band.

Under the plan, trading in a security enters a "limit state" when the national best offer (bid) for the security equals the lower (upper) price band and does not cross the national best bid (offer). If trading does not exit a limit state within 15 seconds, the primary listing exchange must declare a trading pause in the security. Five minutes after declaring this trading pause, the primary listing exchange generally must attempt to reopen trading. If the primary listing exchange is not able to reopen trading within ten minutes after the declaration of a trading pause all other trading centers may begin trading the security unless the primary listing exchange has declared a regulatory halt.

Summary of the Proposed Amendments

The Proposed Amendments would make a number of changes to the Limit Up-Limit Down Plan, the most salient of which would ensure that trading generally resumes on the primary listing exchange following a limit up-limit down pause and that no trading may resume until price bands are in effect.[3] In conjunction with the Proposed Amendments, each primary listing exchange has proposed to amend its rules to provide for standardized, automated reopenings following a trading pause.[4]

Reopening After a Trading Pause

Presently, if the primary listing exchange is not able to reopen trading within ten minutes after the declaration of a trading pause all other trading centers may resume trading the halted security unless the primary listing exchange has declared a regulatory halt. The proposed amendments would require trading to resume on the primary listing exchange—even if it takes longer than ten minutes to reopen trading—unless the primary listing exchange announces that it is unable to reopen trading due to a systems or technology issue.[5] This proposal is designed to facilitate the production of an equilibrium reopening price and improve the accuracy of the reopening price bands.[6]

Ensuring Price Bands are in Place

The Proposed Amendments would address gaps in the current limit up-limit down framework that can permit trading to resume without price bands. The Proposed Amendments would fix this issue by providing that trading centers may not resume trading following a pause without limit up-limit down price bands. The Proposed Amendments also would change the manner in which the limit up-limit down reference price is calculated to ensure that a reference price always will exist for purposes of calculating price bands. The Proposed Amendments note that today, price bands would not exist for some trades that occur within five minutes following the end of a trading pause if trading resumes on a quote with either a zero bid or zero offer or both.

Other Amendments

The Proposed Amendments also would make the following modifications to the Limit Up-Limit Down Plan:

- Clarify the process for determining price bands. Specifically, the Proposed Amendments would make clear that any trading center may calculate and apply so-called "synthetic price bands" when the plan processor has not disseminated price bands. The Proposed Amendments would require the trading center to calculate synthetic price bands based on the same reference price that the plan processor would use for calculating price bands until the trading center receives price bands from the plan processor.
- Ensure that trading does not resume in a security if a trading pause that is declared before the last ten minutes of trading extends into the last ten minutes of trading. In

these circumstances, the primary listing exchange would attempt to execute a closing transaction using its established procedures. This proposed amendment would modify slightly an existing provision that calls for the resumption of trading, except for pauses that are declared in the last ten minutes of trading. The Proposed Amendments note that the participants of the Limit Up-Limit Down Plan (i.e., the self-regulatory organizations) believe that trading should not resume when a security is in a trading pause during the last ten minutes of trading.[7]

- Eliminate the discretion that a primary listing exchange has to declare a trading pause following a straddle state—i.e., a situation when the national best bid (offer) is below (above) the lower (upper) price band and the security is not in a limit state—and make related conforming changes.

Affect certain non-substantive changes to the plan relating to the names of plan signatories and the initial implementation of the plan.

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endnotes

[1] *See* Joint Industry Plan; Notice of Filing of the Twelfth Amendment to the National Market System Plan to Address Extraordinary Market Volatility, 81 FR 87114 (December 2, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-12-02/pdf/2016-28937.pdf, (“Proposed Amendments”).

[2] In response to the volatility on August 24, ICI wrote a letter to SEC Chair Mary Jo White, urging the Commission to take steps to harmonize the process that exchanges use to reopen trading following a limit up-limit down trading pause. See Letter to Mary Jo White, Chair, SEC, from Paul Schott Stevens, President and CEO, Investment Company Institute, dated November 30, 2015, *available at* https://www.ici.org/pdf/29517.pdf.

[3] Effecting these changes requires a number of conforming adjustments throughout the plan.

[4] *See* Securities Exchange Act Release Nos. 79162 (October 26, 2016), 81 FR 75876 (November 1, 2016) available at https://www.gpo.gov/fdsys/pkg/FR-2016-11-01/pdf/2016-26300.pdf; 79158 (October 26, 2016), 81 FR 75879 (November 1, 2016) *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-11-01/pdf/2016-26298.pdf; and 79107 (October 18, 2016), 81 FR 73159 (October 24, 2016) *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-10-24/pdf/2016-25572.pdf.

[5] The Proposed Amendments would provide a different reopening process for situations in which the primary listing exchange is unable to reopen trading due to a systems or technology issue. *See* Proposed Amendments at 87115.

[6] *See id.*

[7] *See* Proposed Amendments at 87117.